BEFORE THE ILLINOIS COMMERCE COMMISSION

Frontier Communications Corporation, Verizon Communications, Inc., Verizon North Inc., Verizon South Inc., New Communications of the Carolinas, Inc.	
Joint Application for the approval of a Reorganization pursuant to Section 7-204 of the Public Utilities Act the Issuance of Certificates of Exchange Service Authority Pursuant to Sections 13-405 to New Communications of the Carolinas, Inc.; the Discontinuance of Service for Verizon South Inc. pursuant to Section 13-406; the Issuance of an Order Approving Designation of New Communications of the Carolinas, Inc. as an Eligible Telecommunications Carrier Covering the Service Area Consisting of the Exchanges to be Acquired from Verizon South Inc. Upon the Closing of the Proposed Transaction and the Granting of All Other Necessary and Appropriate Relief.	Docket No. 09-0268

REPLY BRIEF OF
THE INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, LOCALS 21, 51, AND 702

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I. Introduction

The International Brotherhood of Electrical Workers, Locals 21, 51, and 702 ("IBEW") files this Reply Brief to correct several misstatements contained in the Revised Initial Brief of Joint Applicants ("Applicants' I.B."). Other than the need to correct various factual errors, IBEW's Main Brief ("IBEW M.B.") has fully addressed and refuted the arguments made by Verizon Communications Inc. ("Verizon") and Frontier Communications Corporation ("Frontier").

To be clear: IBEW does not question the good intentions of Frontier. But there are two fundamental problems with Frontier. First and by far the most critical is Frontier's lack of financial capability to do what it says it wants to do – provide safe and reliable service, expand broadband availability, and upgrade the communications network in Verizon Illinois's service territory. Second, as a consequence of its precarious financial condition, Frontier's plans for broadband deployment in Illinois are grossly inadequate. Frontier's plan for Illinois is to relegate much of the State to minimal DSL service and still leave 15% of Verizon Illinois's customers with <u>no broadband service at all</u> <u>four years from now</u>. By the end of 2013, Illinois still would be far behind what Frontier was able to accomplish in other states several years ago. Frontier has offered no reason for its meager commitment to Illinois, but the reason appears obvious: Frontier simply does not have the financial capability to do more.

While IBEW understands the reticence of Commission Staff and the People to reject this transaction and require Verizon to remain in Illinois, IBEW respectfully submits that the public interest requires such a result. If Verizon wants to sell its business, it must find a capable buyer – a buyer that has the capability to finance the transaction (something Frontier still has not been able to do), a buyer who is willing and able to make needed investments in Illinois's telecommunication network, a buyer who can bring 21st Century telecommunications services to Illinois. Sadly, Frontier is not that buyer.

It is for these reasons, not because of some animus toward Frontier or some special longing to remain Verizon employees, that IBEW opposes the proposed transaction. The fundamental flaw in the transaction – Frontier's precarious financial condition – cannot be cured through conditions. It can only be cured through a restructuring of the transaction. Because Verizon and Frontier have refused to restructure the transaction, the Commission must deny the application.

II. Correcting Factual Errors in Joint Applicants' Initial Brief

A. Frontier is not acquiring "all of the operations, assets and obligations of Verizon North and Verizon South."

On page 4 of their Initial Brief, Joint Applicants state that Frontier will acquire "all of the operations, assets and obligations of Verizon North and Verizon South."[1] This is not correct. Joint Applicants have failed to mention one important asset that Frontier will not acquire: working capital. As IBEW explained in its Main Brief (page 12), the agreements between Verizon and Frontier state that Frontier receives no working capital from Verizon – no cash to operate the business, buy supplies, or pay employees. Given the size of this transaction (it would more than triple Frontier's size), Frontier's precarious financial condition, and Frontier's inability to obtain financing for the $3 billion it must pay to Verizon – the lack of working capital should not be overlooked. It must not be assumed that Frontier will have adequate financial capability to finance and run the business from day one.

[1] A similar statement also is made on page 20 of Applicant's Initial Brief.

In addition, this statement ignores the myriad of services provided to Verizon Illinois by Verizon affiliates. Some of those affiliated operations will transfer to Frontier, some will be "replicated" (such as the network operations and 911 centers), and some will become Frontier's responsibility. Hundreds of Verizon employees will need to be retrained before closing[2] and, of course, Frontier's employees and management will need to become familiar with what they are acquiring from Verizon. The transaction is not nearly as simple as the Applicants would want the Commission to believe.

B. IBEW's proposals are not designed to "prevent the delivery of ... public benefits."

Joint Applicants question IBEW's motivation by stating that it wants to "prevent the delivery of [the transaction's] public benefits." Applicants' I.B., p. 6. That is not an accurate statement of IBEW's position. IBEW is urging the Commission to reject the transaction as proposed because it fails to ensure that the new owner will have the financial capacity to deliver those very benefits to the public.

IBEW would like nothing more than to have a telecommunications provider in Illinois that is willing and able to bring 21st Century telecommunications services to Illinois. There is some question about Verizon's willingness to make that investment in Illinois, but it no doubt is capable of doing so. Verizon is a large, financially stable, world-class telecommunications company that is installing state-of-the-art telecommunications networks throughout the country. While Frontier is willing to do a bit more than Verizon has done to date, Frontier is not financially able to deliver on its promises. Moreover, as IBEW discussed in its Main Brief, Frontier's commitments for four years from now fall far short of what Frontier already is providing today in its existing service areas. IBEW M.B., pp. 30-31.

[2] Verizon witnesses testified that approximately five percent of the 9,600 to 9,700 VSTO employees will need to be retrained. Tr. 210-211 (five percent); Tr. 289 (number of employees).

IBEW suggested some modifications to the transaction that would help provide Frontier with the financial capability to do what it wants to do. But the Applicants rejected those modifications and they are not reflected in the transaction that is before the Commission. Those changes were not "draconian" as the Applicants suggest (I.B., p. 6). Rather, they were designed to require Verizon to stay involved to ensure that Frontier can meet its commitments. After Verizon's history of failed divestitures in recent years (see IBEW M.B., p. 25), IBEW respectfully submits that the public interest requires Verizon to either find a capable buyer or to remain involved in the business in a significant way. The proposed transaction does neither and, therefore, must be rejected.

C. Frontier's post-closing leverage ratio will not be "less than 2.6."

Joint Applicants erroneously assert that Frontier's "post-closing leverage ratio will be less than 2.6." Applicants I.B., p. 28. As IBEW discussed in its Main Brief (page 14), this figure is based on a mismatch of actual 2008 data and post-closing (2010 or later) data. In fact, Frontier's post-closing leverage ratio will be closer to 3.0 times.

Specifically, the leverage ratio is net debt (that is, debt minus cash) divided by EBITDA. Frontier Exh. 5.0, 10:208-209. Frontier's post-closing net debt is projected to be $8,005 million. Frontier Exh. 5.1, p. 15. We don't know Frontier's post-closing EBITDA, but we know that it will be nowhere near the actual EBITDA achieved by Verizon and Frontier in 2008. As Mr. McCarthy acknowledged during cross-examination (Tr. 430-431), through the first nine months of 2009, Frontier's EBITDA was approximately $90 million lower than it had been in the same period of 2008.[3] Further, Verizon's EBITDA for the VSTO areas in just the first six months of

[3] In the first nine months of 2009, Frontier's EBITDA (operating income plus depreciation and amortization) was $822.115 million. In the first nine months of 2008, the comparable figure was $913.508 million; a reduction of $91.393 million. IBEW Exh. 10.0, p. 4.

2009 was approximately $180 million lower than it had been in that same period of 2008.[4] Thus, it appears likely that the combined company's EBITDA will be at least $300 million lower at closing than it was in 2008. This would push Frontier's leverage ratio to 2.8 or higher.[5]

But the calculation in Mr. McCarthy's testimony, which is cited on page 28 of Applicants' Initial Brief, is based on 2008 EBITDA, not on a realistic picture of the current condition of VSTO and Frontier. In fact, a Frontier exhibit prepared for Wall Street properly calls this ratio "net debt over '08 EBITDA" rather than referring to it as a projected leverage ratio. Frontier Exh. 5.1, p. 15.

Importantly, this is nowhere near an investment-grade financial profile and it is dramatically worse than Verizon's current leverage ratio of approximately 1.8 times. Frontier Exh. 5.0, 26:658. This provides further evidence of the seriously weakened financial condition that Verizon Illinois would face if this transaction occurred.

D. Contrary to Applicants' assertion, Verizon has been spending significantly more on capital investment than Frontier has spent or plans to spend.

On page 29 of their Initial Brief, Applicants provide some very misleading information about their capital expenditures. They state "on a per-line basis Frontier invests more in its operating companies than Verizon does." This is blatantly incorrect. In the footnote on that page, the Applicants try to explain what they actually meant, which is that Frontier spends more than Verizon if you ignore all of Verizon's investment in state-of-the-art fiber optic facilities. The Applicants never explain, however, why Verizon's investment in fiber optics should be ignored when evaluating each company's commitment to upgrading its network.

[4] In the first six months of 2009, VSTO's EBITDA was $799 million. In the first six months of 2008, the comparable figure was $981 million; a reduction of $182 million. Frontier Exh. 5.10, p. 146.
[5] Net debt of $8,005 million divided by (2008 EBITDA of $3,132 million less $300 million) = 2.8.

The actual data are quite revealing. Within the VSTO areas (that is, the areas Verizon proposes to sell to Frontier), Verizon actually invested $132 per line in 2007 and $153 per line in 2008. IBEW Exh. 2.0, 55:1014-1017. These figures are in excess of the amount that Frontier actually invested in those years, which were $130 per line in 2007 and $128 per line in 2008. Id., 55:1018-1021.

More importantly, Verizon has been investing far more in VSTO than Frontier plans to invest in those same service areas. Id., 55:1022-1026 and IBEW Exh. 1.0, 48-49:893-913.

Simply, Frontier plans to invest less than Verizon actually has been investing in the VSTO area. That difference has very real consequences in Illinois where the sole commitment Frontier has made is to invest a total of $40 million over 3.5 years to install more DSL service. Frontier Exh. 13, p. 8, ¶ 6. That investment averages less than $12 million per year for the approximately 530,000 lines Frontier is acquiring in Illinois – an average of less than $22 per line per year.

It also is puzzling why Frontier's capital expenditure commitment in its settlement with the People and CUB is for only $40 million. Mr. McCarthy testified that Frontier's best estimate of the cost of the broadband expansion was $50 million. Tr. 494-496. By committing to only $40 million in capital expenditures, Frontier is not even agreeing to spend enough money to complete its inadequate broadband plan.

In contrast, the Public Utilities Commission of Ohio recently approved a settlement involving the same transaction where Frontier committed to make capital investments for 3.5 years of at least $110 per access line per year for the approximately 634,000 lines in that state. *In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holdings, Inc., and Verizon Communications Inc. for Consent and Approval of* *a Change in Control*, Case No. 09-454-TP-ACO (OH Pub. Utils. Comm'n, Feb. 11, 2010), pp. 8 ($110 per line) and 16 (634,000 lines).[6] While still inadequate (see IBEW M.B., pp. 32-33), the Ohio commitment vastly exceeds the commitment Frontier has made to invest in Illinois's telecommunications future.

IBEW's concern, of course, is that Frontier just cannot agree to do more. Frontier lacks the financial capability to make the types of investment Illinois needs to improve its telecommunications infrastructure.

III. Conclusion

For the reasons set forth above and in its Main Brief, the International Brotherhood of Electrical Workers Locals 21, 51, and 702 respectfully request the Illinois Commerce Commission to deny the application and reject the proposed transaction because it is not in the public interest.

Respectfully submitted,

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[6]Available at: < http://dis.puc.state.oh.us/ViewImage.aspx?CMID=A1001001A10B11A93526C26258 >

Certificate of Service (Docket No. 09-0268)

The undersigned certifies that a copy of the *Reply Brief of the International Brotherhood of Electrical Workers, Locals 21, 51, and 702* was served upon the following persons by e-mailing a copy of same this 18th day of February, 2010.

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